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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Statutory Review of The System for Regulating Rates and Classes for Market-Dominant Products	Docket No. RM2017-3

COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO ON THE NOTICE OF PROPOSED RULEMAKING FOR THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS

(March 1, 2018)

On December 1, 2017, the Commission gave notice that, having concluded in Order No. 4257 that the market dominant products rate-setting system has failed to meet the statutory objectives of the Postal Accountability and Enhancement Act of 2006 (PAEA), changes in the system were appropriate and necessary through rulemaking. The American Postal Workers Union, AFL-CIO (APWU) submits these comments on modifications to the Commission's proposal to change the price cap by giving the Postal Service additional rate authority.

The Commission's findings on the successes and failures of the rate-setting system make clear that anything less than the additional rate authority the Commission has proposed will conflict with the conclusions and rationale the Commission set out in Order No. 4257 and No. 4258. The Commission concluded in Order No. 4257 that the rate-setting system for market-dominant products has failed to provide financial stability by almost all measures of that Objective. (Order No. 4257 at 178.) This failure exposes the fundamental flaw of the price cap. Experience has shown that throughout the ten years of the PAEA era, the price cap has prevented the Postal Service from generating enough revenue to support the network and provide reliable service.

The Commission's proposed rulemaking addressing the short-comings of the price cap is a step in the right direction, but it is not enough. On the record created and analyzed by the Commission, nothing less than the supplemental and performance-based rate authority the Commission has proposed is defensible. In fact, the Commission's own findings call for the Commission to do more than it has proposed. Compounding the problems arising from the rate-setting system, the overall structure Congress put in place with the PAEA suffers from significant problems. (Order No. 4257 at n.254.) This structure puts additional pressure on the Commission to ensure it gives the Postal Service enough pricing flexibility through the rate-setting system to both manage these systemic problems and maintain or regain financial stability and service. This is clearly a moment that calls for action. If the Commission acts too conservatively now, the next five years is sure to see further degradation not only in service and finances, but in all aspects of the rate-setting system.

Rather than suggest an entirely new structure and approach, APWU's suggested changes maintain and build upon the structure of additional rate authority the Commission has already proposed. In Part I, APWU looks at the rulemaking through a legal lens to identify aspects of the proposed rulemaking the Commission must maintain or improve upon, but not cut, as it moves to a final rule. In Part II, we propose a critical modification of the supplemental rate authority the Commission has proposed to increase the target net loss amount to a more justifiable figure. In Part III, we suggest revising the operational efficiency benchmark for the performance-based rate authority to require capital investment plans rather than increases in Total Factor Productivity, a modification that brings the benchmark in line with the Commission's underlying rationale for performance-based authority.

PART I: The Legal Sufficiency of the Final Rule Depends on Using the Proposed Rulemaking as a Baseline

Experience has certainly demonstrated that the price cap is a significant source of the Postal Service's revenue problems. APWU agrees with the Commission that the PAEA's rate-setting system has not allowed the Postal Service to achieve the statutory Objectives of financial stability and service. (Order No. 4258 at 26.) APWU also agrees with the Commission that it is unacceptable for the Commission to keep the price cap system unchanged. (Order No. 4258 at 33.) As we stated in our earlier Comments, APWU believes the price cap should be eliminated entirely. Because, however, the Commission is committed to maintaining the cap, it must do so in a way that addresses the Commission's own findings of problems and failings in the present rate-setting system. The conservative plan the Commission has proposed to raise the cap by giving the Postal Service a modest amount of additional rate authority does not fully align with the Commission's findings and rationale. This calls into question its legal sufficiency. To put the final rule on solid legal grounding, the Commission should revise the rule to increase the Postal Service's rate authority.

The Commission follows the Administrative Procedure Act principle that its final rule find clear justification in the evidence, rationales, and findings the Commission assessed and made in Order No. 4257 and No. 4258. The Commission has a legal duty to "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines v. United States,* 371 U.S. 156, 168 (1962)). If the Commission's rulemaking is not grounded in its conclusion that medium- and long-term financial stability and service have been compromised by the system's limits on the revenue generated for market-dominant products, the final rule will be arbitrary and capricious.

The findings the Commission has made plainly support the conclusion that a final rule cutting back the additional rate authority the Commission has proposed would not be legally sufficient. The Commission has measured the Postal Service's financial stability in the short, medium, and long-term, recognizing that the Postal Service needs stability in all three periods to have stability in any one. (Order No. 4258 at 28.) Presently, the Commission concludes that the Postal Service has achieved only short-term financial stability. (Order No. 4257 at 165; Order No. 4258 at 35.) Medium- and long-term stability, the Commission has concluded, have not been met because the Postal Service is consistently running annual net losses and cannot generate enough revenue to build retained earnings. (Order No. 4257 at 169, 171; Order No. 4258 at 35.) The Commission's initial ideas for correcting the rate-setting system to address these deficiencies are already conservative; the Commission does not appear to have proposed more than it believes the Postal Service needs or can use. But unless the Commission overstated the Postal Service's deficits,[1] which we would agree it has not, (Order No.

[1] The Commission correctly rejects the suggestion to ignore the retiree health benefit (RHB) pre-funding expense in the Commission's calculations of the Postal

4258 at 35 ("Beyond the short-term, however, the Postal Service's financial health is in jeopardy."), there simply is no basis for the annual revenue targets the Commission is using to justify the supplemental rate authority and the performance-based incentive be any lower than what is proposed. It follows, therefore, that any change to the additional rate authority that generates less revenue than presently expected under the Commission's proposal is inconsistent with the Commission's conclusions on the very minimum of what is necessary to satisfy the PAEA's requirements.

The Commission should proceed within the general structure it has already proposed. Although the Commission is entitled to reconsider its proposed rulemaking in response to public comment, *see Commodity Futures Trading Com'n v. Schor*, 478 U.S. 833, 845 (1986), the Commission should exercise restraint in doing so. Adopting a radically different approach in the final rules without strong justification for changing the result of ten months of analysis and strategizing and without an additional round of notice and comment will be difficult to justify legally. Accordingly, the Commission should revise the rate-setting system in the manner it has proposed but increase the additional rate authority so that it has the potential to generate more revenue than it presently is likely to

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Service's financial situation. (Order No. 4257 at 155-56.) Commissioner Hammond notes this issue, and while he appropriately critiques Congress for saddling the Postal Service with the RHB pre-funding obligation, it is a statutory mandate that cannot be ignored. Because it is mandated by law, recalculating the Postal Service's shortfall without including this expense lacks the requisite rigor required of the Commission. *Motor Vehicle Mfrs. Ass'n*, *id*. ("[A]n agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.")

generate. In the following sections, we lay out how that can be achieved consistent with the Commission's Orders and the Objectives of the PAEA.

PART II: Analysis of the Supplemental Rate Authority – Supplemental Rate Authority Should Be Greater than Two Percent Per Annum

Supplemental rate authority of only two percent per year for the next five years is not enough for the Postal Service to achieve medium- and long-term financial stability. The Commission proposes that medium-term financial stability can be gained by supplemental authority that could generate enough additional revenue to cover the FY2017 net loss of $2.7 billion. The $2.7 billion understates previous losses and losses reasonably expected in future years. The Commission's findings both support and demand that the Postal Service be given more supplemental authority that it can use sooner.

A. APWU Critique of the Two Percent/Year Supplemental Rate Authority – Too Little, Too Late

The Commission defines medium-term financial stability as positive net income (total revenue minus [attributable costs + institutional costs]). (Order No. 4257 at 165.) By the Commission's measure, the Postal Service has never achieved medium-term financial stability in the PAEA era; the "Postal Service's net loss ranged from $2.8 billion to $15.9 billion" for the entire first ten years since passage of the PAEA. (Order No. 4258 at 40; Order No. 4257 at 168-69.)

The Commission nonetheless picked the most recent fiscal year's net loss of $2.7 billion as the amount the Postal Service needs to generate beyond regular price cap rate increases to achieve medium-term financial stability. (Order No. 4258 at 40-41.) The target amount of $2.7 billion to make up past net losses and mitigate future ones is the smallest annual loss the Commission could use. The $2.7 billion is certainly low as compared to the almost $50 billion in total net losses over ten years. (Order No. 4257 at 154.) The Commission acknowledges that $2.7 billion, alone, is insufficient to put the Postal Service on solid financial footing, and that the Postal Service is certain to have even greater losses in each of the next five years. (Order No. 4258 at 41 ("…the proposed supplemental rate authority is not designed to provide sufficient revenue to cover costs.").) The Commission's rationale and findings show that limiting the Postal Service to an additional two percent of supplemental rate authority per year for five years will not position the Postal Service to achieve sufficient positive net income and regain the medium-term financial stability it had prior to the PAEA.

The target the Commission is trying to reach with its supplemental rate authority is simply too low. Using only one year, and the smallest loss in the last eleven years, is not a sound foundation on which to build the supplemental rate authority. The $2.7 billion net loss from FY2017 is not only the lowest loss of the past decade, but it is the product of certain model changes and assumptions that may not recur in the future. Using the FY2017 net loss as a putative proxy for future losses requires assumptions that current performance, costs, and demand will not change. Even the Commission acknowledges that is not at all likely. (Order No. 4258 at 21.) For example, without worker's compensation model changes made for 2017, the $2.7 billion net loss would have been $4.9 billion. While those changes reduced the liability associated with worker's compensation costs for one year, it is unknown whether those changes and their results will continue in the same manner for the next five years.

More worrisome is the impact of normal declines in market dominant mail volume. The Commission notes that "[g]iven these recent volume trends and the effects of price elasticity, the assumption of constant mail volumes results in revenue estimates the Commission reasonably anticipates will be higher than the revenues that the proposed rate adjustment authority would actually generate." (Order No. 4258 at 42.) Having found that mail volume is expected to fall in the future, the Commission nonetheless did not use a five-year estimate of that trend in calculating what amount supplemental rate authority would produce the modest revenue target of $2.7 billion.[2]

Moreover, as first class mail volume trends down[3] and the delivery network grows, institutional costs can be expected to add pressure on postal finances. Diminishing volume and the expanded network needed to meet the universal service obligation will push institutional costs up in the short-term. Despite the growth trends, increases in shipping volumes and revenue in the next five years will be insufficient to mitigate the loss of First Class mail volume and revenue. As the Commission observed, for example,

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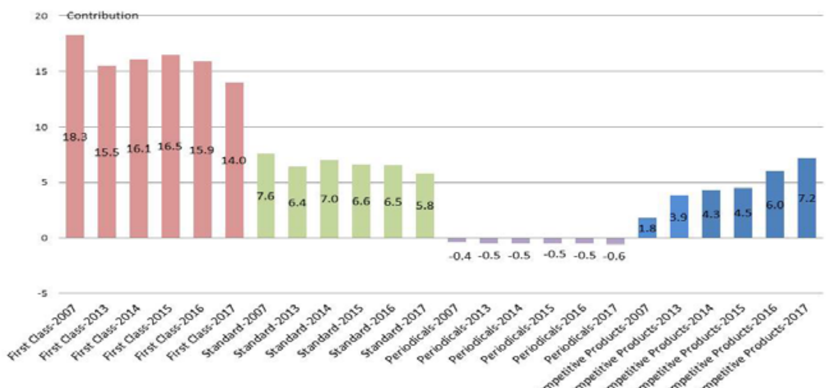
[2] If the Postal Service makes full use of all of the two percent supplemental authority in Year 1, the supplement would generate less than $2 billion in revenues that initial year.

[3] A theoretical concern that supplemental rate authority will singularly drive mail volume down is overstated. The best evidence of this is the Commission-approved exigency surcharge of approximately 4.3%. For first class letters, the exigency resulted in a single piece increase of two cents (from 47 cents to 49 cents). Metered mail also increased by two cents (from 46 cents to 48 cents), and 5-digit went up 2.1 cents (from 36 to 38.1 cents.) As Commissioner Hammond noted in his dissent to the rulemaking, "…the exigent surcharges that were in effect from 2014 to 2016 appeared not to result in any significant volume loss." (Order No. 4258, *Dissenting Views of Commissioner Tony Hammond* at 2.)

between FY2016 and FY2017 the Postal Service lost $2.7 billion in contribution toward institutional costs from first class mail, marketing mail, and periodicals. While it gained $1.2 billion towards institutional costs from competitive products, the Postal Service was still left $1.5 billion short from the lost institutional cost coverage by first class mail.



Shipping Services (Competitive Products) reflects reclassification of products from the market dominant to the competitive products from 2008 on. Package & Ancillary Services reflects some loss of volume to the Competitive Products category.

Regaining the amount of the FY2017 net loss will not generate enough additional revenue for the Postal Service to realize a break-even or net gain. An additional $2.7 billion in revenue each year will, at best, marginally lessen future annual losses. It is evident from the consistent pattern of net losses that the PAEA price cap system will continue to generate net losses each year. Recovering the loss of one year may offset part of future losses, but it is unlikely to completely erase them and does nothing to generate retained earnings and much needed capital. To truly address the issues identified by the Commission, consistent with projections reasonably flowing from the Commission's review and investigation, supplemental authority tied to a higher revenue target is necessary.

In light of near unanimity among commentators and the Commission that the Postal Service is failing in service, directing the Postal Service to make up shortfalls in the supplemental rate authority with further cost reductions and greater productivity gains is imprudent. (*See* Order No. 4258 at 41, 42.) The conclusion that the Postal Service can keep cutting expenses to make up for the shortfall in the supplemental rate authority is not supported by the record. The Commission found that throughout the PAEA era the Postal Service has continually cut costs and increased efficiency. (Order No. 4257 at 226.) And while the Commission concludes that there is room for more cuts, it fails to show that there is room for the kind of exponential cost-cutting and productivity gains needed to make up the revenue shortfall. Compelling the Postal Service to make up for lost revenue with yet more cuts conflicts with the findings that the system has failed to meet the service Objective.

With regard specifically to productivity – a way to cut costs without cutting service - the Commission acknowledges the chicken and egg situation the Postal Service is in. The Commission observed, for example, that declines in mail processing productivity may be due to “aging machines and a lack of capital investment in the PAEA era.” (Order No. 4257 at 216.) The same can be noted about the postal fleet. Ancient vehicles require frequent and expensive maintenance, refurbishment of parts that are no longer made, more fuel, and often multiple trips to and from delivery units because older vehicles do not have the capacity to handle the growing volume of packages in a single trip. But without revenue to invest in the network to make the infrastructure more efficient, productivity gains are limited and significant gains are impossible.

It is wishful thinking, if not irrational, to count on cost-cutting and productivity improvements to mitigate revenue losses when the Postal Service will not be able to generate retained earnings and capital to make improvements in the network and operations. Here it seems that the Postal Service is expected to overcome losses and generate earnings and capital from cost-cutting and productivity improvements. Yet it is capital that allows for smart cost reductions and significant productivity improvements.

Spreading the supplemental rate authority evenly over five years compounds the problems associated with the low $2.7 billion target. Rather than a one-time increase or a true-up, or even a graduated scale of percentage increases, the proposed rule spreads the supplemental rate authority over five years to prevent “rate shock” to mailers. The two percent supplemental rate authority the Commission proposes does not get the Postal Service to $2.7 billion in year one. If the Postal Service makes full use of all of the two percent supplemental authority in year one, that supplement would generate less than $2 billion in revenues in the initial year. Two percent per year becomes a slow walk towards the Commission’s target allowing cumulative annual net losses to grow.

Any concern about frontloading supplementary rate authority is neither necessary nor prudent for two main reasons. First, the theoretical concern of a negative effect on mail volume from a rate increase to capture the full $2.7 billion in year one or that gets closer to the target earlier in the five-year period is overstated. The best evidence of this is the Commission-approved exigency surcharge of approximately 4.3% in addition to the regular rate increase for every mail product. For First Class letters, the exigency resulted in a single piece increase of two cents (from 47 cents to 49 cents). Metered mail also increased by two cents (from 46 cents to 48 cents), and 5-digit presort went up 2.1 cents (from 36 to 38.1 cents.) During the exigency period, the Commission confirmed that mail volume did not respond to the increase rates with a significant decrease in volume related to the increase. To the contrary, mail volume dropped faster after the exigency was removed. Although the mailers will surely complain that any rate increase will drive mail volume lower, the evidence suggests that such claims of rate shock are hyperbole. Mailers should expect improved service with an improved revenue stream. Frontloading supplemental rate authority should not, therefore, significantly impact demand.

Second, the Commission should have confidence in the rate-setting process itself which the Commission finds to be one of the successes of the PAEA. (Order No. 57 at 56, 62, 65, 71, 81, 85.) Permitting the Postal Service rate authority is not the same as the Postal Service using that authority. The Commission should rely on the Postal Service to settle on a rate increase that makes the most sense with regard to economic conditions, demand, and service. The Postal Service will not pursue suicidal rate increases. And the rate-setting process itself, as the Commission found in its review, still provides the transparency and notice necessary for users of market-dominant products to plan and adjust.

B. Improving the Proposed Supplemental Rate Authority

The record shows that medium-term financial stability has been a problem for the entire period the PAEA model has been in place. The Commission should increase the amount of supplemental authority and frontload increases so that the Postal Service can meet both medium- and long-term financial sustainability goals.

The Commission should begin by raising the target amount the supplemental authority is intended to generate. The Commission should look at the ten-year period of this review to determine a target net loss amount that includes making up for past losses and addressing future ones. Using the Commission's rationale of relying on experience to make projections, the target net loss amount should be based on an average of the adjusted net losses and gains for the ten years of the review period. The average net losses of the Postal Service over the decade from 2007 through 2016 shows an average annual net loss of $6.2 billion per year. (Order No. 4257 at 168, Table II-10 *Postal Service Net Income (Loss) FY2007-FY2016*.) Even if one used the Postal Service's borrowing authority to offset those losses, the average annual net loss over the ten-year period is still $4.8 billion. (Order No. 4257 at 169, Table II-11 *Adjusted Net Income FY2007-FY2016*.) Notably, this adjusted figure is very close to the net loss of $4.9 billion that the Postal Service would have reported in FY2017 if the Postal Service had not made interest rate changes and other revisions to the long-term workers' compensation calculations causing a significant decline in workers' compensation liabilities.

Using the more realistic and accurate average of $4.8 billion of annual net losses as a revenue target, a different schedule and amount of supplemental rate authority is necessary. Achieving an average $4.8 billion increase in revenues on market dominant products could be accomplished with a one-time supplemental authority of 10.5%, assuming there are no changes in mail volume and ignoring elasticity impacts. But recognizing the Commission's rate shock concern, a schedule of supplemental rate authority that frontloads increases can substantially accomplish the same result. Giving the Postal Service supplemental rate authority of four percent (4%) in Years 1 and 2, three and a half percent (3.5%) in Year 3, and two percent (2%) in Years 4 and 5 will generate an average increase of $4.8 billion year over the five-year period. Frontloading the revenue also satisfies the goal of achieving medium- and long-term financial stability.

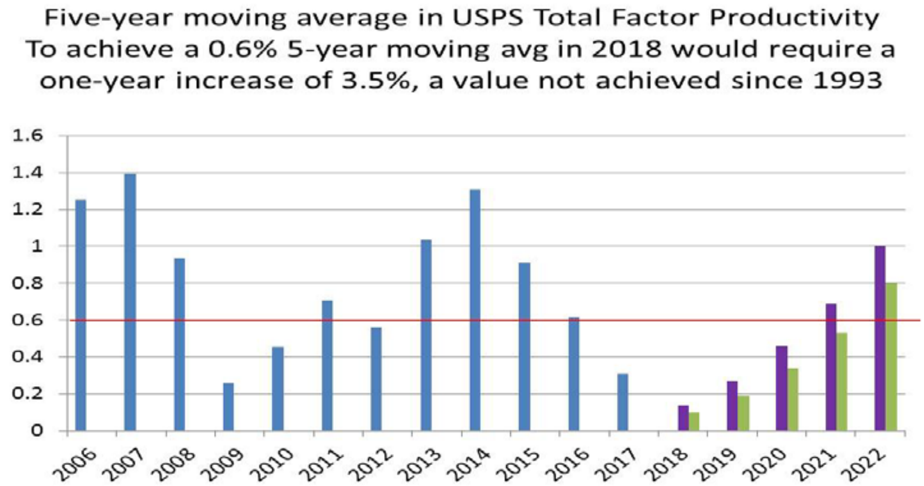
PART III: Analysis of the Performance-Based Rate Authority

The revenue from additional rate authority through a performance-based concept is needed for reinvesting into the network. But the performance benchmark for operational efficiency must be changed so it is comparable to the service standards benchmark and is obtainable and reasonably measured within a rate case. The quarter percent benchmarked to maintaining service standards is obtainable and measurable; the three quarters for realizing a 0.6 percent growth in Total Factor Productivity (TFP) is not. The TFP benchmark should be replaced by a capital investment plan benchmark to incent Postal Service plans and action consistent with the Commission's reasoning for proposing a performance-based rate authority in the first place.

The Commission's proposed performance incentive authority is premised on the Postal Service meeting two benchmarks around quality of service. Three quarters of the one percent for demonstrating operational efficiency is tied to meeting a benchmark of productivity gains and one quarter of the one percent is tied to maintaining service standards. We take issue with the operational efficiency incentive, which suffers from being impossible to meet, is not reasonably objective or measurable in a rate case, and does not correlate with the Commission's rationale for the performance-based authority of incentivizing the Postal Service to make capital investments.

The Commission bases its proposed performance-based rate authority on the need for the Postal Service to earn revenue to go into retained earnings from which it can make capital investments. The Commission notes repeatedly that these capital investments are the lynchpin to the Postal Service improving service as well as increasing operational efficiency, i.e. higher productivity and lower operational costs. (Order No. 4258 at 46, 47, Figure III-2 *Financial Health Cycle*, 52 ("The Postal Service's sharp decline in capital investments contributed to the system not achieving Objective 1 ('maximize incentives to reduce costs and increase efficiency'), Objective 3 ('maintain high quality service standards established under section 3691"), and Objective 5 ('assure adequate revenues, including retained earnings, to maintain financial stability').).) But the Commission's operational efficiency incentive using a 0.6 percent annual increase in Total Factor Productivity as the benchmark puts the cart before the horse -- the Postal Service's opportunity to raise revenue for capital investments using the performance-based authority is earned by the Postal Service first demonstrating improved productivity *without* access to capital. In other words, to generate the revenue for capital investments that will drive improvements in productivity and TFP, the Postal Service must first improve productivity and TFP.

Given the recent history of the Postal Service's Total Factor Productivity and the fact that the Commission expects the Postal Service to show productivity gains before it has the revenue to make needed capital investments, significant increases in TFP are impossible for the Postal Service to meet. The following chart shows the five-year moving average of the Postal Service's Total Factor Productivity:



The five-year average of TFP changes in 2017 is 0.3 percent. Yet the Commission proposes that the Postal Service achieve a five-year TFP average of 0.6 percent. The Commission sets this goal based on the five-year average of TFP changes from 2011 to 2016. But given the 2014-2017 values of the TFP index, to reach the 0.6 percent benchmark in 2018, the Postal Service would have to generate a TFP of about 3.5 percent. The last time TFP was over three percent was in 1993. Even at a consistent one percent per year growth rate (purple bars of chart), the Postal Service could not meet the 0.6 percent benchmark until four years into the new system. If TFP grew at an average annual rate of 0.8 percent (the average for the last ten years), it would not reach the 0.6 percent benchmark for five years (green bars of chart).

The 0.6 percent TFP benchmark the Commission has identified is, based on the evidence before the Commission, plainly unachievable. The Commission acknowledges that the Postal Service needs revenue for capital investments that will allow it to maintain and improve service. The current infrastructure will only deteriorate further without capital investment but with the growing pressure of declining mail volume and increasing delivery points. These factors combine to depress productivity. The Commission should note that with little money for capital improvements, the Postal Service must spend those dollars on keeping its facilities open and its fleet on the road. Capital spent on deferred maintenance in older facilities or remanufacturing unavailable parts for thirty-year old vehicles is essential to continued operations and must be spent in preference to other investments; but the return on investments like these – performance of capital is part of the TFP calculation – can be negative. The result is that the Postal Service, which is already below the 0.6 increase in TFP productivity standard for the performance-based rate authority, is expected to improve over its past productivity even as circumstances deteriorate. The Commission points to nothing that suggests the Postal Service can meet the Commission's benchmark in this situation. On the Commission's reasoning, this will leave the Postal Service stuck in a cycle from which it cannot emerge, as it is forced to forego the performance-based authority that the Commission intends as the main revenue driver for establishing retained earnings from which to make capital investments.

In addition to being unobtainable, measuring and assessing TFP in a rate case compromises the efficiency of the rate-setting process. While the Commission notes that TFP is already calculated and submitted to the Commission by the Postal Service outside of rate cases, its use as a rate-setting benchmark opens it and the rate-setting process up further to legal challenge. The overall efficiency of the rate-setting process, itself one of the PAEA Objectives that the Commission finds the system is meeting, is also jeopardized by the Commission inserting in rate cases this additional factor to be calculated by the Postal Service, assessed by the Commission, and litigated by interested parties. Thus, it is inconceivable that the Postal Service can meet the Commission's TFP benchmark and TFP adds too much complication to the rate-setting process. The TFP benchmark as designed in the proposed rulemaking is, therefore, an arbitrary and capricious standard on which to condition rate authority.

The Commission should instead establish a benchmark for the ¾ of one percent of performance-based authority on the core result it is trying to achieve. The Commission concludes that capital investment is vital to the Postal Service improving its efficiency and ultimately improving service – capital investment is, the Commission concludes, a critical part of the Postal Service's financial cycle and sustainability. (Order No. 4258 at 53.) The Commission also found that capital outlays have consistently and sharply decreased since passage of the PAEA, and that the steep decline in capital investments has contributed to the system failing to meet many Objectives. (Order No. 4258 at 52, 54.) The Commission directs, therefore, that revenue from the performance-based authority be used to return the Postal Service to its pre-PAEA rate of capital investment. (Order No. 4258 at 54.)

Even in a period during which the Commission anticipates declining revenue, it concludes that capital investment will increase operational efficiency. Increasing productivity, the Commission explains, is not the purpose for raising revenue, capital investment is; the Commission's performance-based authority is meant to incent investment. Waiting to see the results of investments before granting the incentive puts the incentive out of reach. It is arbitrary, therefore, to require productivity gains to happen before the Postal Service can raise revenue from which to make the very capital improvements that increase productivity and overall operational efficiency and improve service.

The adjustment to the performance-based authority standard is as simple as the Commission using the same type of benchmark for operational efficiency as it proposes for the service component. The Commission benchmarked a quarter of one percent of the performance-based authority to the Postal Service not changing its service standards. The Commission observes that service standards, not service *performance*, are the appropriate benchmark – so long as the standards do not change, the Postal Service has a quarter of a percent rate authority at its disposal. (Order No. 4258 at 71.) Using the service standards as the benchmark is a clear statement to the Postal Service of what action is being measured, it is obtainable, and it offers a definite measure that can be cleanly and quickly made within a rate case. As the Commission observes, using the standards as the incentive benchmark does not absolve the Postal Service from its obligation to meet them. But the Commission can better assess and address service performance as part of the Annual Compliance Review rather than as a sub-issue in a rate case.

A similar standard should be used as the benchmark on productivity and capital investments. Rather than using changes to TFP as the benchmark, the Commission should make the benchmark a measure such as the Postal Service outlining capital outlay and investment plans in its rate case that the additional rate authority would be used to fund. The Commission observes that the Postal Service calculates Total Factor Productivity annually and files it with the Commission outside of the rate-setting process, and that exercise can and should continue for the Commission to address the myriad of related issues surrounding TFP in those other proceedings. (Order No. 4257 at 205, 207.) But to earn the authority for additional rate-setting tied to the Postal Service providing good service, the benchmark should be capital investment plans. Like with service, this positions the Postal Service to articulate a goal in the short term, and gives the Postal Service revenue to accomplish those goals. This is objective, achievable, and keeps the rate-setting process streamlined and efficient.

PART IV: Conclusion

APWU appreciates the opportunity to submit these comments and to contribute to improving the Commission's rulemaking on the rate system for Market Dominant Products. In summary, APWU recommends the Commission include the following provisions in its final rulemaking:

1. Change the amount of supplemental rate authority to four percent (4%) in Year 1, four percent (4%) in Year 2, three and a half percent (3.5%) in Year 3, and two percent (2%) in Years 4 and 5.
2. Change the performance-based rate authority benchmark for operational efficiency from a 0.6 percent increase in Total Factor Productivity to provision of proposed capital investment and outlay plans for the applicable fiscal year.
3. Upon expiration of the five-year period for these provisions, if modifications have not been implemented to replace any or all of these changes, continue the availability of the last year of the period's supplemental and performance-based rate authority until they have been replaced.

Respectfully submitted,

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